No. 10235

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Appellant

v.

RICHARD E. SEWARD and HELEN ROBERTS, Liquidating Trustees of CON-ROD EXCHANGE, INC., a Corporation,

Appellees

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR THE APPELLANT

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Assistant Attorney General.
SEWALL KEY,
SAMUEL H. LEVY,
GEORGE H. ZEUTZIUS,
Special Assistants to the Attorney General.

J. CHARLES DENNIS,
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OPINION BELOW

The District Court rendered no opinion but entered special findings of fact and conclusions of law which are unreported. (R. 52-61.)

JURISDICTION

This is an appeal from a judgment of the District Court entered March 4, 1942 (R. 61-62), and cor-

rected pursuant to stipulation on May 8, 1942 (R. 63-65), in favor of appellees in an action brought by them on September 28, 1940, pursuant to the provisions of Section 24, Fifth, of the Judicial Code for the refund of $2,286.88 assessed and paid as manufacturers excise taxes for the periods June 21, 1932, to September 30, 1935, and October 1, 1936, to September 30, 1938, pursuant to Section 606(c) of the Revenue Act of 1932. Appellees were the last directors and liquidating trustees of Con-Rod Exchange, Inc., a Washington corporation.

Refund claims were filed on February 17 and April 11, 1940, within four years after the date of payment, and were rejected by the Commissioner of Internal Revenue on April 18 and July 31, 1940, respectively. (R. 56.)

Notice of appeal was filed June 1, 1942 (R. 65), and an order was entered by the District Court on July 7, 1942 (R. 66), extending the time for 90 days within which to file and docket the record on appeal. The jurisdiction of this Court is invoked under Section 128(a) of the Judicial Code, as amended.

QUESTIONS PRESENTED

1. Whether sales of automobile connecting rods by the taxpayer corporation were taxable under Section 606(c) of the Revenue Act of 1932, which im-

posed a tax upon automobile parts "sold by the manufacturer, producer, or importer" thereof.

2. Whether under the circumstances involved a prior decision for taxpayer respecting taxes paid on similar articles produced and sold during a different period was *res judicata* with respect to this action.

3. Whether there was competent evidence to support the court's finding that the burden of the taxes was borne by the corporation and not passed on to its vendees or purchasers.

STATUTE AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*.

STATEMENT

This case was tried to the court without a jury upon the pleadings, testimony of four witnesses offered by taxpayer, certain oral stipulations during the trial, and documentary exhibits. The Government offered no evidence. The court entered findings of fact and conclusions of law (R. 52-61) in favor of taxpayers.

The District Court's findings of fact may be summarized as follows:

At all times herein mentioned prior to January 8, 1940, Con-Rod Exchange, Inc., the corporation on behalf of which the suit was brought, was a corporation organized, existing and doing business under the laws of the State of Washington. It was legally dissolved on January 8, 1940. The appellees, Richard E. Seward and Helen Roberts, were its last directors and liquidating trustees, and this cause of action thereby vested in them. (R. 53-53.)

In 1936 the corporation was determined to be liable for an assessment of manufacturers' excise taxes in the principal sum of $2,019.64, and for interest in the sum of $188.28, under the provisions of Section 606(c) of the Revenue Act of 1932. This assessment was for excise taxes for the period from June 21, 1932, to September 30, 1935, upon the manufacture and sale by the corporation of certain automobile parts, to-wit, connecting rods. A further assessment was determined for the period from October 1, 1936, to September 30, 1938, in the amount of $78.96. (R. 53-54.) These taxes were paid on divers dates from November 16, 1936, to March 22, 1940. (R.54-56.) Claims for refund were filed and were disallowed by the Commissioner on April 18, 1940, and July 31, 1940. (R. 56.)

On August 9, 1939, an action was tried in the same court before Judge Leon R. Yankwich, in which Con-Rod Exchange, Inc., sought to recover from the Collector of Internal Revenue manufacturers' excise taxes assessed and collected under Section 606(c) of the Revenue Act of 1932 for the period from October 1, 1935, to August 31, 1936. The court, on August 30, 1939, made findings of fact and conclusions of law, and thereupon entered judgment in favor of the plaintiff corporation. (R. 56.) *Con-Rod Exchange, Inc. v. Henricksen*, 28 F. Sup. 924 (W. D. Wash.) [1]

The court found that the type of material used in the operations of this corporation, the physical process of "rebabbitting" the connecting rods, and the basis upon which the business was conducted, were identical in their nature during the periods involved in this action and in the preceding suit, [2] except that

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[1] Plaintiff's Exhibits No. 2, consisting of the amended complaint, defendant's answer, opinion of the court, findings of fact, conclusions of law and judgment in the prior proceeding (R. 111-128), was admitted in evidence over the objection of Government counsel (R. 112).

[2] Finding IX in the prior action was in material part as follows (R. 25-26):

> The rebabbitting consisted in applying a metal alloy to the inside and edges of the bearing

it was stipulated that all of the taxes herein involved were levied upon transactions in which customers of the corporation exchanged old connecting rods on which the babbits had been worn, for newly rebabbitted one or "exchange sales" similar to those which constituted the largest part of the corporation's busi-

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formed by the detachable cap and the large end of the shank of the rod. * * * Plaintiff purchased shanks from wrecking houses, either in Seattle or elsewhere, to establish a stock in a particular type of connecting rod. After a stock was once established, individual customers would bring in used shanks for rebabbitting. If the plaintiff had in stock a rebabbitted connecting rod of the same size and type as the customer's, it was given in exchange to the particular customer. In the case of new automobile models, with new types of connecting rods, the plaintiff would purchase some new connecting rods from the automobile manufacturers. To rebabbitt the rod a used forging or shank, after the cap and the shank had been separated, was placed in a container of hot babbitt, which would melt off and dissolve the old babbitt still adhering to the old forging. The forging was then placed in an acid solution which cleaned off all grease and dirt. Then the new alloy was applied to the bearing by pouring, after which the surface of the new babbitt was evened so that the cap and the shank would fit together again. The inside of the new babbitted bearing was rough-bored to a size slightly smaller than what was to become the finished diameter, then a broaching occurred, which, finally, resulted in providing the prescribed diameters. The connecting rods were then placed in plaintiff's stock.

ness during the period involved in the prior suit.[3] The court further found that all other material facts involved in the present action were also involved in the preceding action heard by the court below, excepting only the amount of the assessment of and the time of the payment of the taxes, the refund of which is herein sought; the period of time for which they were assessed by the Collector; and the time of the filing by the corporation of the claim for refund in accordance with the Internal Revenue Code and the regulations of the Commissioner of Internal Revenue. (R. 57.)

The court in the prior cause found that the larg-

> The used connecting rod consisted primarily of a forging formed by a shank and cap fastened together by bolts, which formed an opening constituting the bearing intended to contain a babbitted surface. * * *

Judge Yankwich in a footnote to his opinion stated, in adopting a portion of the Government's brief, as follows (R. 127-128):

> In some instances, a process of "rebushing" is necessary in the small end of the connecting rod, and when necessary new bolts and nuts and shims are supplied.

[3] The reference to the largest, rather than the smallest, part of the corporation's business involved in the prior suit was obviously an inadvertent error. (See R. 27.)

est part of the assessment of those excise taxes was made with respect to sales by this corporation of rebabbitted connecting rods; that the rebabbitting process performed by the taxpayer therein upon the connecting rods, and in respect to which the excise taxes therein involved were imposed, whether on an "exchange basis" or on a basis wherein customers received back their own repaired rods, constituted the repair, rehabilitation or reconditioning of used and second-hand connecting rods; that the sale of rebabbitted connecting rods did not constitute sales of automobile parts or accessories by a manufacturer, producer or importer in any instance; that the taxpayer corporation did not include the excise taxes in the price of the articles with respect to which the taxes were imposed and it did not collect the amount of the taxes or any part thereof from the vendee or vendees of the articles in respect to which the taxes were imposed. (R. 57-58.)

The court concluded that the taxpayer corporation was not, during the times involved in that suit, the manufacturer, producer or importer of automobile connecting rods or of any automobile parts or accessories whatsoever within the meaning of Section 606 of the Revenue Act of 1932; and that the excise tax imposed by Section 606(c) of the Revenue Act of

1932 did not apply to sales to rebabbitted automobile connecting rods by one who acquired such rods second-hand and rebabbitted the same and who neither manufactured, produced nor imported any other automobile parts or accessories. The court thereupon entered judgment for the taxpayer in the principal amount of the taxes assessed for the period therein concerned. That judgment now is and stands unreversed and unmodified and in full force and effect. (R. 58-59.)

The court in the instant case further found that the corporation did not include the excise taxes here in question in the price of the articles with respect to which the tax was imposed; that it did not collect the amount of the taxes or any part thereof from the vendee or vendees of the articles in respect to which the taxes were imposed; and that the burden of the taxes was borne solely and exclusively by the corporation and the burden of none of the taxes was passed on by the corporation to its customers or vendees. [4] It concluded that the prior decision in the *Con-Rod Exchange, Inc.*, case *supra*, was *res judicata* in this cause with respect to whether or not the taxes were properly assessed and collected, and that therefore the corporation was not during the time involved in this

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[4] The testimony upon which these findings were made was admitted over objection of Government counsel. (R. 107, 108, 110-111, 139.)

suit the manufacturer, producer or importer of automobile connecting rods within the meaning of Section 606 of the Revenue Act of 1932. (R. 60.) Judgment was thereupon entered for the appellees. (R. 61-64.)

STATEMENT OF POINTS TO BE URGED

Appellant relies upon all of the points set forth in the record (pp. 67-69, 137-139). The main points are that the District Court erred in determining (1) that the sales of connecting rods by the corporation during the taxable period involved herein were not sales of automobile parts or accessories by a manufacturer or producer thereof within the purview of Section 606(c) of the Revenue Act of 1932; (2) that the previous decision by Judge Yankwich on August 17, 1939, is *res judicata* in this cause with respect to the issue of taxability; and (3) that the burden of none of the taxes was passed on by the corporation to its customers or vendees.

SUMMARY OF ARGUMENT

Processes and operations substantially similar if not identical with those of the taxpayer corporation were held by this Court in *United States v. Arma-*

ture Exchange, 116 F. (2d) 969, *United States v. J. Leslie Morris Co.*, 124 F. (2d) 371, and *United States v. Moroloy Bearing Service*, 124 F. (2d) 373, to constitute production of automobile parts within the meaning of the taxing statute. Under these authorities the decision obtained by the taxpayer corporation in the earlier case of *Con-Rod Exchange, Inc., v. Henricksen*, 28 F. Supp. 924 (W. D. Wash.), is admittedly no longer law. That case involved different transactions occurring in a different period of time. Therefore, it should not be held to be *res judicata* here.

Moreover, the District Court's finding that the corporation bore the burden of the tax which it seeks to have refunded is not supported by the evidence. The taxpayers could not in any event recover unless this fact had properly been established.

The court erred in admitting in evidence over objection various records taken from the previous action and in overruling objections to certain testimony given by the taxpayers' witnesses. The judgment, ultimate findings and conclusions of the court below are not supported by the evidence, are erroneous and should be reversed.

ARGUMENT

I.

THE TRANSACTIONS INVOLVED CONSTITUTE SALES OF AUTOMOBILE PARTS BY THE MANUFACTURER OR PRODUCER THEREOF WITHIN THE MEANING OF THE TAXING STATUTE AND UNDER THE REASONING OF A LONG LINE OF FEDERAL COURT DECISIONS.

Taxpayers, by their counsel, admitted during the trial that the principle of the prior decision obtained by their corporation was overruled by this Court in the *Armature* case [*United States v. Armature Exchange*, 116 F. (2d) 969, certiorari denied, 313 U. S. 573].[5] (R. 83.) It was also agreed (R. 77) and the court so found (R. 57) that the connecting rods alleged to have been "rebabbitted" by taxpayer corporation were *sold* by it on the *exchange basis of sale* for automotive replacement parts. No evidence was offered tending to establish that any of the taxed transactions were mere repair jobs (R. 129), as were a majority of the transactions involved in the prior case.

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[5] The Government did not appeal the prior decision primarily because of the small amount involved ($254.80) and the fact that the *Armature Exchange* case, likewise decided by Judge Yankwich, was pending as a test case.

Under the present state of the law, therefore, the automobile connecting rods involved in this action admittedly were produced and/or manufactured by the taxpayer corporation, as well as sold by it during the periods June 21, 1932, to September 30, 1935, and October 1, 1936, to September 30, 1938, fall within the purview of Section 606(c) of the Revenue Act of 1932, and were subject to tax liability thereunder. This conclusion follows, not only from this Court's decision in the *Armature Exchange* case, *supra*, but also from the following cases all of which arose under the same taxing section and involved comparable facts and similar contentions:

United States v. J. Leslie Morris Co., 124 F. (2d) 371 (C.C.A. 9th), involving "rebabbitted" connecting rods;

United States v. Moroloy Bearing Service, 124 F. (2d) 373 (C.C.A. 9th), involving "rebabbitted" connecting rods;

United States v. Armature Rewinding Co., 124 F. (2d) 589 (C.C.A. 8th), involving "rewound" armatures and "rebuilt" generators;

Clawson & Bals v. Harrison, 108 F. (2d) 999 (C.C.A. 7th), certiorari denied, 309 U. S. 685, involving "rebabbitted" connecting rods;

Edelmann & Co. v. Harrison (N.D. Ill.), decided April 7, 1939 (1939 Prentice-Hall, par 5, 379), involving "rewound" armatures and "rebuilt" generators;

Federal-Mogul Corp v. Smith (S.D. Ind.), de-

cided February 23, 1940 (1940 Prentice-Hall, par. 62, 510), involving "rebabbitted" connecting rods;

Moore Brothers, Inc. v. United States (N.D. Tex.), decided May 14, 1940 (1940 Prentice-Hall, par. 62, 676), involving "rebuilt" armatures;

Motor Mart v. United States (N.D. Tex), involving "rebuilt" generators and armatures, was decided for the Government on May 14, 1940, without opinion (Civil Action No. 239);

Replacement Unit Co. v. United States (N. D. Ohio), decided December 17, 1941 (1942 Prentice-Hall, par. 62, 388), involving "rebuilt" automobile clutch pressure assemblies;

Carty Electric & Armature Service, Inc. v. United States (Colo.), decided February 13, 1942 (1942 Prentice-Hall, par. 62, 562), involving "rebuilt" armatures;

Niagara Motors Corp. v. McGowan, 45 F. Supp. 346 (W.D. N.Y.), involving "rebabbitted" connecting rods;

Southern Armature Works v. United States (N.D. Ala.), decided September 10, 1942, involving alleged repaired and rebuilt armature and generators. Judgment entered for Government following the sustaining of its motion to dismiss. Not reported.

The decisions of the Canadian courts are in harmony with those of our own, cited above:

Biltrite Tire Co. v. The King, 1937 Canada Law Rep. 364, arose under the War Revenue Act of 1927, and involved language similar to that used in Section 606(c) of the United States

Revenue Act of 1932. The Supreme Court of Canada held that so-called "retreaded" automobile tires were subject to tax upon their sale by the retreader which contended it was not the manufacturer or producer thereof;

The King v. Biltrite Tire Co., 1937 Canada Law Rep. 1, is the preceding case in the lower court. The court reviewed various American decisions and rejected the retreaded tire case of *Skinner v. United States*, 8 F. Supp. 999 (S.D. Ohio);

The King v. Boultbee, Ltd. [1938], 3 Dominion Law Rep. 664, involved "retreaded" automobile tires made by the taxpayer on a small scale. These were held taxable. Taxpayer also did considerable retreading of tires for customers to whom the tires were returned. The latter transactions were not sought to be taxed because they did not involve a sale of the completed article but merely a contract for the furnishing of materials and labor.

It should be observed that the correctness of the principle established by the foregoing decisions was approved by Congress when it refused to exempt in the Revenue Act of 1941 rebuilt automobile parts from the payment of manufacturers' excise tax. The Senate Committee on Finance in its report on this subject (S. Rep. No. 673, Part 1, p. 48, 77th Cong., 1st Sess.) said, in part:

> There are several decisions of the United States Circuit Courts of Appeals holding rebuilt parts and accessories to be subject to the manufacturers' tax. Rebuilt parts compete with new parts, and it appears appropriate that they should

be subject to the same tax. Accordingly, no change has been made.

Even more recently it was again attempted by representatives of members of the automotive replacement parts industry, within which category the taxpayer corporation falls, to amend the section so as to exclude such parts from tax. (See House Hearings before Committee on Ways and Means, 77th Cong., 2d Sess., Revenue Revision of 1942, Vol. 2, pp. 1907-1921; also Senate Hearings before Committee on Finance, 77th Cong., 2d Sess., Revenue Act of 1942, Vol. 1, pp. 1143-1152.) However, no amendments were made, and the 1942 Revenue Act was enacted leaving the taxing provision in question in full force and effect, with the five per cent rate provided by Section 3403(c) of the Internal Revenue Code, as amended by Section 209 of the Revenue Act of 1940, c. 419, 54 Stat. 516, and Section 544 of the Revenue Act of 1941, c. 412, 55 Stat. 687. Under Section 544 *supra*, the tax rate on auto parts and accessories was raised to five per cent, whereas during the time involved in the present suit it was two per cent.

II.

THE DOCTRINE OF *RES JUDICATA* IS INAPPLICABLE TO THE INSTANT ACTION UNDER THE FACTS AND CIRCUMSTANCES DISCLOSED, PARTICULARLY IN VIEW OF THIS COURT'S INTERVENING DECISIONS

The court below did not disagree with the foregoing conclusions. Its decision was based upon the ground that the prior decision involving the application of this tax for different periods of time was *res judicata*. Accordingly, irrespective of the correct interpretation of the statute generally, this corporation, under the court's decision, would not be a "manufacturer" subject to the tax. We submit that this was an erroneous application of the doctrine of *res judicata*.

The precise issue in this case is whether or not the corporation was a manufacturer or producer during the periods June 21, 1932, to September 30, 1935, and October 1, 1936, to September 30, 1938, with respect to the automobile parts it sold. The corporation's activities in these periods were not those of the period October 1, 1935, to August 31, 1936, previously litigated. They were comparable and similar in nature but the sales transactions, the articles sold, and the production operations were completely differ-

ent events. They were not the same set of events litigated in the earlier action.

This proceeding involves a different claim or demand. It is not a reassertion of the identical claim or demand (for $254.80) involved in the previous action. Different facts are involved, although they may be in many respects similar in nature. The issue of whether or not the corporation passed on the taxes (of $2,286.88) now sought to be recovered was not involved in the earlier action.

A further and very material fact, which did not exist at the time of the earlier decision, but which did exist when this action was tried, was that this Court had decided adversely to several of the corporation's competitors in three cases involving the identical principle with respect to which the corporation was successful in its previous action. When the decisions of this Court were rendered in the *Armature Exchange, J. Leslie Morris Co.* and *Moroloy Bearing Service* cases, *supra*, the law was established for the first time within this Circuit. *Mercantile Nat. Bank v. Lander*, 109 Fed 21, 24 (C.C. N.D. Ohio). This new and additional fact was before the trial court in the present case. (R. 82-83.) The latter fact in and of itself should be sufficient to preclude the operation of the doctrines of *res judicata*, assuming it otherwise

would be applicable. See *Blair v. Commissioner*, 300 U.S. 5, wherein it was held that the rule of *Tait v. Western Maryland Ry. Co.*, 289 U. S. 620, was not applicable where, after the decision in the first proceeding, a decree of a state court as to the validity of an assignment created a new situation.

Yet, taxpayers have asked the court in the present proceeding to close its eyes to the facts before it and to give them a judgment which the court would not give to any other taxpayer whose cause of action had equal merit. The court is asked in actual effect to sanction a discrimination between these taxpayers and all other taxpayers merely because this corporation had previously obtained an earlier District Court decision which involved the application of the tax over a different period of time and which now admittedly appears to have been erroneous. The application of the doctrine of *res judicata* in such circumstances would serve no other purpose than to perpetuate a past error.

The doctrine of *res judicata* should not be so extended. As applied to excise taxes, as distinguished from income taxes, where different taxable periods are involved in two cases, the doctrine, if applied at all, should be applied narrowly. Not only should it

be confined to issues which are identical in the two cases, but the world "identical" should be rigidly construed. Otherwise, there would result discrimination against all other persons similarly situated, as members of the same industry, affected by the particular excise tax provisions. Such discrimination clearly would be contrary to public policy. Moreover, with the upward trend of the tax rate — it is now five per cent of the sales price — situations might easily be supposed in which the discrimination might spell the difference between the ability of the competing corporation, subject to the tax, to remain in business at a small profit on the one hand or financial ruin on the other.

We believe that the reasoning of the Supreme Court in *United States v. Stone & Downer Co.*, 274 U. S. 225, which sanctions a limited application of the doctrine to customs cases, should be followed here because similar considerations are present in the administration of the manufacturers' excise tax law. In the latter case, the Court sustained the Court of Customs Appeals which held that a previous decision construing the tariff statute and classifying merchandise thereunder was not *res judicata* in respect of a subsequent importation involving the same issue of fact and the same question of law. The Court said

(pp. 235-237):

We think that, not only was it within the power of the Court of Customs Appeals to establish the practice, but that it was wise to do so. The effect of adjudicated controversies arising over classification of importations may well be distinguished from the irrevocable effect of ordinary tax litigation tried in the regular courts. There of course should be an end of litigation as well in customs matters as in other tax cases; but circumstances justify limiting the finality of the conclusion in customs controversies to the identical importation. The business of importing is carried on by large houses between whom and the Government there are innumerable transactions, as here for instance in the enormous importations of wool, and there are constant differences as to proper classifications of similar importations. The evidence which may be presented in one case may be much varied in the next. The importance of a classification and its far-reaching effect may not have been fully understood or clearly known when the first litigation was carried through. One large importing house may secure a judgment in its favor from the Customs Court on a question of fact as to the merchandise of a particular importation, or a question of construction in the classifying statute. If that house can rely upon a conclusion in early litigation as one which is to remain final as to it, and not to be reheard in any way, while a similar importation made by another importing house may be tried and heard and a different conclusion reached, a most embarrassing situation is presented. The importing house which has, by the principle of the thing adjudged, obtained a favorable decision permanently binding on the Government will be able to import the goods at a much better rate than that enjoyed by other importing houses, its com-

petitors. Such a result would lead to inequality in the administration of the customs law, to discrimination and to great injustice and confusion. In the same way, if the first decision were against a large importing house, and its competitors instituted subsequent litigation on the same issues, with new evidence or without it, and succeeded in securing a different conclusion, the first litigant, bound by the judgment against it in favor of the Government, must permanently do business in importations of the same merchandise at great and inequitable disadvantage with its competitors.

These were doubtless the reasons which actuated the Court of Customs Appeals when the question was first presented to it to hold that the general principle of *res judicata* should have only limited application to its judgments. These are the reasons, too, why the principle laid down by this Court in the decision already referred to, in *New Orleans v. Citizens' Bank*, 167 U.S. 371, should not apply or control.

The reasoning of the Supreme Court in the preceding case fits precisely the circumstances involved here.

We have learned, in handling these excise tax cases, that thousands of persons and firms have been similarly engaged in the production and sale of automobile parts comprised of a combination of new and used materials. Approximately one-half of all automotive replacement parts sold have been so comprised. The other half has been made up entirely of new ma-

terials. Both groups of manufacturers have been members of the automotive replacement parts industry and compete with each other. All of these taxpayers, being similarly situated, are entitled to equal treatment under the law. The successful invocation of the doctrine of *res judicata* by a few of these taxpayers would not serve to effect equality or uniformity of treatment before the law or by the courts.

So considered the wisdom of the Supreme Court's reasoning in the *Stone & Downer* case *supra*, is emphasized. It is immaterial that no rule respecting manufacturers' excise taxes yet has been promulgated similar to that long ago adopted in the Customs Court. Until recently, the need for such a rule had seldom been apparent but, with higher tax rates, it has become very important.

The Court of Claims in *Engineers Club of Phila. v. United States*, 42 F. Supp. 182, 187, recently passed upon a substantially similar situation in a suit for the refund of taxes on dues and initiation fees. It appeared that for a period preceding that before the Court of Claims, the taxpayer had obtained two decisions in its favor from the District Court for the Eastern District of Pennsylvania. One of the previous actions was against the Collector of Internal Revenue and the other against the United States and

it was held in both that plaintiff was not a social club and was entitled to recover the taxes paid on club dues and initiation fees for the period January 1932 to June 1935. The period involved before the Court of Claims was July, 1935 to January, 1938. The taxpayer contended that the decisions of the District Court in its favor holding that it was not a social club with respect to the earlier period was *res judicata* of the question for the succeeding period. In rejecting the applicability of the doctrine the Court of Claims stated (p. 187):

> Plaintiff's activities in the latter period, here in question, were not those of the earlier period, previously litigated. They were comparable and similar. We have found that they were substantially the same in nature and extent. But they were a completely different set of events, and they were not the set of events litigated in the earlier cases. We are asked, then, to close our eyes and minds to the facts actually before us, and to give to plaintiff a judgment which we would not give to any other plaintiff whose cause of action had equal merit. We are asked thus to discriminate with regard to a public and recurring duty, the duty to pay taxes, thus setting plaintiff apart from all other taxpayers who resort to this court with similar cases.
>
> The doctrine of *res judicata* should not be so extended. Any application of the doctrine in tax cases to relieve a taxpayer of, or to subject him to the payment of, a tax in a later year because of litigation with reference to an earlier year, has been criticized. A learned commentator has point-

ed out that the invocation of the doctrine in tax cases has promoted litigation instead of producing peace, as the doctrine is supposed to do.[3] The instant case is an example. In addition to trying the facts of plaintiff's operations for the three years here in question, it has been necessary to try again the facts which were tried before the District Court covering another period of years, in order to determine whether they were so substantially similar that the doctrine of *res judicata* would have to be considered. The learned authority cited above suggests the following approach to the question: "Where different taxable years are involved in the two cases, *res judicata* should be applied much more narrowly than has been true in some cases in the past. Not only should it be confined to issues which are identical in the two cases, but the word 'identical' should be rigidly construed to apply only to situations where the applicable statute is unchanged and all of the controlling events occurred before the earlier of the tax years."[4]

The Supreme Court denied certiorari in this case on June 1, 1942.

Similarly, in *Duquesne Club v. Bell*, 42 F. Supp. 123 (W.D. Pa.), involving a suit for the refund of taxes paid with respect to club dues and initiation fees, the court held that a previous decision by the Court of Claims (23 F. Supp. 781), holding the Club

[3] Griswold, Res Judicata in Tax Cases, 46 Yale L.J. 1320 (1937).
[4] Griswold, op, cit. at p 1357.

to be a "social club" and taxable, was not *res judicata* with respect to whether it was a "social club" during a later period. Although the District Court was reversed (127 F. (2d) 363 (C.C.A. 3d), certiorari denied, October 12, 1942), such reversal did not involve the court's ruling with respect to *res judicata.*

We recognize that there are a substantial number of cases holding that a question of fact determined in a previous suit involved in an earlier tax year is *res judicata* in a subsequent suit for a later tax year. However, they are not excise tax cases and they do not involve the interpretation of a general taxing provision. In virtually all of them the question was one which in its very nature was unchanging and unchangeable — for instance, the right to take a deduction from gross income for amortization of bond discount on sales of particular bond issues *(Tait v. Western Maryland Ry. Co., supra)*; the value of timber on a specific date *(Donald v. J. J. White Lumber Co.*, 68 F. (2d) 441 (C.C.A. 5th)); the amount of earnings of a corporation over a particular period *(James v Commissioner*, 31 B.T.A. 712). The doctrine has also been applied to mixed questions of law and fact but there too the conclusion related to a matter inherently the same in each year, *e.g.*, whether certain transactions constituted a gift of stock from husband to wife

(Marshall v. Commissioner, 29 B.T.A. 1075), and whether contracts had a value on a particular date *(Worm v. Harrison*, 98 F. (2d) 977 (C.C.A. 7th)). Even in cases involving questions almost exclusively conclusions of law, the rule applied if the facts on which the conclusions rested were fixed, *e.g.*, the determination of the construction and legal effect of a will *(Haller v. Commissioner*, 26 B.T.A. 395, affirmed, 68 F. (2d) 780 (App. D.C.)).

On the other hand, the rule of *res judicata* has been held inapplicable in cases where the facts may change from year to year, *e.g.*, determination of whether a corporation was "doing business" *(Phillips v. International Salt Co.*, 274 U.S. 718; or whether a corporation's activities were "charitable" *(Peck v. Commissioner*, 34 B.T.A. 402); or, whether a group of corporations was "affiliated" in the respective tax year *(J. M. Smucker Co. v. Keystone Stores Corp.*, 12 F. Supp. 286 (W.D. Pa.), affirmed *sub nom. Franklin v. United States*, 83 F. (2d) 1010 (C.C.A. 3d)). Even a case involving the rate of depreciation of certain machinery has been held to be free from application of the rule on the ground that it necessarily involved a continuing judgment as to the depreciation rate, which judgment might properly and honestly vary from year to year. *Tait v. Commissioner*, 78 F. (2d)

193 (C.C.A. 3d).

In the light of the foregoing discussion and decisions, including the three intervening decisions of this Court and the long line of decisions of other federal courts throughout the United States, cited in Argument I, *supra*, we submit that the determination that the taxpayer corporation was not the manufacturer or producer of the connecting rods it sold during a different period from that here involved is not *res judicata* on the question of whether it was the manufacturer or producer of the articles it sold during the periods now in question. The District Court erred in reaching a contrary conclusion. By the same token, it erred in admitting in evidence, over the objection of the Government, the records of the prior action (R. 112), and in making its findings respecting that action, Nos. VI through IX (R. 56-59), and its conclusions, Nos. II through V (R. 60-61).

III.

TAXPAYERS HAVE FAILED TO ESTABLISH THAT THEIR CORPORATION BORE THE BURDEN OF THE TAX AND DID NOT PASS IT ON

Finally, even if we should assume that the corporation was not a "manufacturer" subject to the tax,

taxpayers have failed to meet the burden of proving that the taxes were borne exclusively by the corporation and not passed on to its vendees or purchasers. The only evidence offered on this score was the following:

Appellee Seward testified, over objection of Government counsel, that no tax was added in the bill or on the invoice. (R. 107.) This was clearly a conclusion of the witness, unsupported by any records or proffer thereof. It was not the best evidence, and was incompetent. On cross examination, the witness stated that they arrived at the invoice price by taking prices of some of the locally advertised connecting rods; others, they just made — took them from the general market. (R. 107.) They did not bill any additional tax as a separate item. (R. 107.) They used prices of Federal-Mogul and a concern in San Francisco. (R. 108.)

The witness Taylor identified himself as a public accountant, auditor for Con-Rod Exchange, Inc., since 1924, and as being familiar with the corporation's method of billing during the period 1934 to 1936. (R. 109.) He was permitted to testify, over objection by Government counsel, that the retained copies of duplicates of bills did not show the tax added. (R. 110-111.)

The only other testimony thereon was adduced on direct examination of the witness Evans, who had been connected with the Excise Division of the Collector's office and had had something to do with auditing the accounts of Con-Rod Exchange for manufacturers' tax purposes several years before. (R. 91-92.) He testified (R. 95):

> Q. Did you find, in any case, that they billed any customer with any amount as tax on the sales?
>
> A. I don't remember; on the other hand, it seems to me I do remember they had records with tax being on, some of those invoices.
>
> Q. But you don't remember?
>
> A. No, I wouldn't want to go on record.
>
> Q. Did you make any report whether they had passed the tax on or not?
>
> A. No, I didn't.

We have challenged the court's ruling with respect to the foregoing objections. (R. 139, Point X.)

The above evidence clearly would not have justified a determination by the Commissioner of Internal Revenue that the taxpayer corporation had met the requirements of Section 621(d) of the Revenue Act of 1932 (Appendix, *infra)*. One of the reasons assigned by the Commissioner in his letters rejecting the refund claims was the apparent failure to estab-

lish that the tax was not passed on to the customers but was borne by the taxpayer corporation. (R. 40.) Consequently, the court's findings No. X (R. 59) — a prerequisite to any recovery — that the corporation did not include the tax in the price of the articles sold, but itself bore the burden thereof, is clearly without any competent supporting evidence and therefore erroneous. *Jergens Co. v. Conner*, 125 F. (2d) 686 (C.C.A. 6th); *Piver, Inc. v. Hoey*, 101 F. (2d) 68 (C.C.A. 2d), and *Luzier's, Inc. v. Nee*, 106 F. (2d) 130 (C.C.A. 8th).

CONCLUSION

The judgment of the District Court should be reversed

Respectfully submitted,

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APPENDIX

Revenue Act of 1932, c. 209 47 Stat. 169:

SEC. 606. TAX ON AUTOMOBILES, ETC.

There is hereby imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

* * *

(c) Parts or accessories (other than tires and inner tubes) for any of the articles enumerated in subsection (a) or (b), 2 per centum. * * * *

[Note: Subsections (a) and (b) refer to automobiles, automobile trucks and motor cycles.]

SEC. 621. CREDITS AND REFUNDS.

* * *

(d) No overpayment of tax under this title shall be credited or refunded (otherwise than under subsection (a)), in pursuance of a court decision or otherwise, unless the person who paid the tax establishes, in accordance with the approval of the Secretary, (1) that he has not included the tax in the price of the article with respect to which it was imposed, or collected the amount of tax from the vendee, or (2) that he has repaid the amount of the tax to the ultimate purchaser of the article, or unless he files with the Commissioner written consent of such ultimate purchaser to the allowance of the credit or refund.

[Note: Sec. 3443 (d) of the Internal Revenue Code, approved February 10, 1939, is to the same effect.]

Treasury Regulations 46, approved June 18, 1932:

ART. 4. *Who is a manufacturer or producer.*—As used in the Act, the term "producer" includes a person who produces a taxable article by processing, manipulating, or changing the form of an article, or produces a taxable article by combining or assembling two or more articles.

* * *

ART. 41. *Definition of parts or accessories.*—The term "parts or accessories" for an automobile truck or other automobile chassis or body, or motorcycle, include (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, or (c) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

* * *

ART. 71. *Credits and refunds.*—

* * *

If any person overpays the tax due with one monthly return, he may either file a claim for refund on Form 843 or take credit for the overpayment against the tax due with any subsequent monthly return. In all cases (except those referred to in section 621 (a), discussed under the preceding paragraphs of this article) where a person overpays tax, no credit or refund shall be allowed, whether in pursuance of a court decision

or otherwise, unless the taxpayer files a sworn statement explaining satisfactorily the reason for claiming the credit or refund and establishing (1) that he has not included the tax in the price of the article with respect to which it was imposed, or collected the amount of tax from the vendee, or (2) that he has either repaid the amount of the tax to the ultimate purchaser of the article or has secured the written consent of such ultimate purchaser to the allowance of the credit or refund. In the latter case the written consent of the ultimate purchaser must accompany the sworn statement filed with the credit or refund claim. The statement supporting the credit or refund claim must also show whether any previous claim for credit or refund covering the amount involved, or any part thereof, has been filed with the Collector or Commissioner.

A complete and detailed record of all overpayments must be kept by the taxpayer for a period of at least four years from the date a credit is taken or refund claimed.

Treasury Regulations 46, approved January 8, 1940:

SEC. 316.4 *Who is a manufacturer.* — The term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

* * *